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Corporate Governance in Japanese Law: Recent Trends and Issues

*Hideki Kanda**

I. INTRODUCTION

This article discusses recent trends and issues concerning corporate governance in Japanese law. In the following article, “corporate governance” refers to publicly-held business corporations. Where this article refers to that in the stock exchange and listed firms, it means the Tokyo Stock Exchange (“TSE”) and the listed firms whose stocks are listed on the markets of the TSE.

There is a vast body of academic research on corporate governance in Japan and other jurisdictions, and in practice, corporate governance is in a state of flux. Thus, it is not possible in this article to discuss all aspects of corporate governance in Japan. The purpose of this article, however, is to offer brief overviews on selected topics, including empirical studies, recent scandals, board structure, rule making by the stock exchange, disclosure rules under Japanese securities regulation, and the forthcoming reform of Japanese corporate law.

At the outset, a brief note on corporate law and securities regulation in Japan may be noteworthy. Firms incorporated in Japan whose stocks are listed on the TSE are subject to the Companies Act of 2005, the Financial Instruments and Exchange Act of 1948 (“FIEA”), and the rules promulgated by the TSE.

In Japan, the Companies Act (effective from May 1, 2006) applies to all joint-stock companies. The Companies Act provides for

* Professor of Law, University of Tokyo. This article is based on my presentation at the Corporate Governance Conference at the University of California, Hastings College of the Law on October 18, 2013. I thank Professor Setsuo Miyazawa and the participants in the conference for their helpful comments.

private law rules about joint-stock companies. The Act is a consolidation of the statutes that existed in 2005 in respect of corporate law rules governing joint-stock companies in Japan. Until such consolidation, corporate law rules were codified primarily as part of the Commercial Code of 1899. The Commercial Code is of German origin, but as far as the rules on business corporations are concerned, it transplanted many American rules after World War II.¹ Today, the Companies Act also reflects numerous amendments made in the past decades to the Commercial Code and contains the result of such historical developments in Japan. Thus, the Companies Act today exhibits its own, somewhat unique, landscape.²

FIEA applies to large publicly held companies.³ The name of the Act was changed to its present name by the amendments in 2006 (effective from September 30, 2007). Until then, the Act was called the Securities and Exchange Act (“SEA”). The SEA was modeled on the U.S. Securities Act of 1933 and Securities Exchange Act of 1934, but again, it reflects the unique historical developments in Japan in the past decades. The Act, therefore, has its own characteristics not identical to the rules in the U.S.

Sometimes, the Companies Act and the FIEA regulate the same matters. For instance, both Acts require public companies to prepare financial statements and have them audited by professional auditors. In usual practice, companies prepare those documents and have them audited at one time so as to satisfy the requirements under both Acts.

The Companies Act is a private law, and there is no administrative branch or agency of government that enforces the rules under the Companies Act. As an exception, public registry offices are understood to enforce the rules applied to the matters that must be registered, but this is not discussed in this article. Of course,

1. See, e.g., Mark D. West, *The Puzzling Divergence of Corporate Law: Evidence and Explanations From Japan and the United States*, 150 U. PA. L. REV. 527 (2001).

2. See, e.g., Hideki Kanda, *Understanding Recent Trends Regarding Liabilities of Managers and Directors in Japanese Corporate Law*, 17 ZEITSCHRIFT FÜR JAPANISCHES RECHT 29 (2004).

3. A company whose securities are listed on a stock exchange, traded “over the counter,” or the number of whose registered shareholders is five hundred or more, is subject to the periodic reporting requirements of the FIEA. A company that has made a public offering is also subject to the same reporting requirements.

the courts enforce the rules of the Companies Act. In contrast, the FIEA has an administrative body of the government, the Financial Services Agency (“FSA”), and an enforcement body, the Securities and Exchange Surveillance Commission. The FIEA is also enforced by the courts.

II. EMPIRICAL STUDIES

In recent years, a number of empirical studies have been conducted concerning corporate governance in Japan.

A. DEFENSIVE TACTICS AGAINST HOSTILE TAKEOVERS

The area of takeover defenses is complicated with respect to the law’s coverage. The FIEA regulates tender offer processes, while most of the defense measures raise legal issues under the Companies Act, not the FIEA. In this sense, the distinction between the FIEA and the Companies Act roughly corresponds to that between the federal (and state) securities law and state corporate law in the United States. It is interesting to note that the validity of some of the defenses was challenged before the courts. In those cases, the relevant issues were the ones under the Companies Act, not the FIEA.⁴ In fact, the current tender offer regulation under the FIEA permits the target company to adopt a defense action even after the commencement of a tender offer by a hostile bidder. Thus, like in Delaware, case law under the Companies Act shapes the landscape, although the substance of the case law is not identical between Delaware and Japan.

In a well-known case that occurred in May 2007, Steel Partners, a U.S. buy-out fund, commenced a hostile tender offer for all outstanding shares of Bulldog Sauce, a Worcester sauce producer and a listed company on the TSE. Bulldog Sauce did not have any “pre-bid” defense plans. As a post-bid defense, the board of directors

4. See generally Kenichi Osugi, *Transplanting Poison Pills in Foreign Soil: Japan’s Experiment*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 36 (Hideki Kanda et al., eds., 2008).

of Bulldog Sauce intended to issue stock warrants to all shareholders, including Steel Partners and its affiliates (collectively “SP”), with the condition that SP could not exercise the warrants. The warrants had a redemption feature, by which the warrant holders other than SP would receive common stocks in exchange for turning the warrants into the company, whereas SP would receive cash. Thus, the scheme was structured as a scheme diluting the voting right of SP without imposing an economic loss on SP (not including the value of the voting right). The Bulldog Sauce board introduced the proposal at the annual shareholders’ meeting on June 24, 2007, and shareholders holding more than eighty percent of the total shares approved the plan. SP sued to enjoin the issuance of the warrants. The Tokyo District Court ultimately held on June 28, 2007, that the scheme was valid.⁵ The decision was affirmed by the Tokyo High Court on July 9, 2007,⁶ and then by the Supreme Court on August 7, 2007.⁷ The relevant issues were the ones under the Companies Act, and not the FIEA.⁸

Also, a number of public firms in Japan have one of the two types of “pre-bid” defense plans. As of September 10, 2012, 2,275 firms were listed on the TSE, and 441 out of those 2,275 listed firms (14.9 percent) had pre-bid defense plans.⁹

Pre-bid defense plans take two forms. The first is a typical trust-based scheme, where the firm issues stock warrants to a trust bank with designating shareholders as beneficiaries of the trust. A hostile bid triggers the defense plan, and the trust bank transfers the

5. See *Steel Partners Japan Strategic Fund (Offshore), L.P. v. Bull-Dog Sauce Co., Ltd.*, 1805 SHOJI HOMU 43 (Tokyo D. Ct., June 28, 2007).

6. See *Steel Partners Japan Strategic Fund (Offshore), L.P. v. Bull-Dog Sauce Co., Ltd.*, 1805 SHOJI HOMU 40 (Tokyo High Ct., July 9, 2007).

7. 1809 SHOJI HOMU 16 (Sup. Ct., Aug. 7, 2007).

8. See Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171 (2005). See also Jack B. Jacobs, *Implementing Japan’s New Anti-takeover Defense Guidelines, Part II: The Role of Courts as Expositor and Monitor of the Rules of the Takeover Game*, 3 U. TOKYO J.L. & POL. 102 (2006); Hideki Kanda, *Takeover Defenses and the Role of Law: A Japanese Perspective*, in PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION 413 (Michel Tison et al., 2009).

9. See TOKYO STOCK EXCH., WHITE PAPER ON CORPORATE GOVERNANCE 2013 95 (2013), available at <http://www.tse.or.jp/rules/cg/white-paper/b7gje60000005ob1-att/b7gje6000003ukm8.pdf> [hereinafter TSE WHITE PAPER 2013].

warrants to the shareholders. The warrants have a discriminatory feature and the bidder has no right to exercise them, as the terms and conditions of the warrants usually provide that the warrants are not exercisable by the shareholders who own twenty percent or more of the firm's outstanding stocks.¹⁰ This plan is not popular today. The second, more popular plan is called the advance-warning plan. This plan varies from company to company but its typical style is as follows. The board, sometimes with the approval of the shareholders' meeting, makes a public announcement that if a shareholder attempts to increase its stake to twenty percent or more of the firm's outstanding stocks, the shareholder is first required to disclose and explain, in accordance with the details specified in the announcement, its intent to hold such stake and what the shareholder would do for the firm. If the shareholder does not answer these questions or if the target board thinks the shareholder's explanation is unsatisfactory, then a defense measure would be triggered. Such defense measure is typically to issue stock warrants to all shareholders; however, the shareholder having twenty percent or more cannot exercise the warrants. Instead, the shareholder can redeem her warrants at a fair price at the option of the company. Thus, a warrant issuance typically has the effect of "cashing out" the hostile bidder.¹¹

It is interesting to note that under the Companies Act, it is possible to establish defense plans that rely on different classes of shares. For instance, a firm may issue a special class of stock that does not have voting power for the part of the stock exceeding the twenty percent stake of all outstanding stocks. To issue such stocks, the Companies Act requires the firm to provide details of such stocks in the firm's charter. A firm issuing common stocks may convert them into such special class stocks by a charter amendment, which requires two-thirds approval at the shareholders' meeting. However, in practice no company has introduced such class stocks. There is discussion in academia as to whether such stocks are always lawful.

10. See Kanda, *supra* note 8, at 419.

11. Note, however, that after the report by the Corporate Value Study Group at the Ministry of Economy, Trade, and Industry on June 30, 2008 took a general position against paying compensation to hostile bidders for their economic loss they may suffer when the defense action is triggered, advance warning plans generally do not provide such payment.

The TSE takes the view that such stocks are not appropriate for existing listed firms, as opposed to firms making IPOs.¹²

Thus, the Companies Act is important for the critical issues in the area of hostile takeovers and defenses, and courts play an important role in applying the relevant rules under the Companies Act. The TSE also plays an important role in shaping the landscape in this area, since such issues are not directly regulated by the FIEA, and thus, there is no room for their enforcement by the FSA.

As noted above, beginning in 2005, some listed firms adopted pre-bid defense plans against hostile takeovers in the form of advance warning defense plans noted above. There is an empirical study showing that a positive correlation was found between firms that adopted defense plans in 2005 and firms that showed poor economic performance.¹³ The authors report that such correlation was not found for firms that adopted defense plans in 2006.¹⁴ Note that for the firms that adopted defense plans in 2005, causality is not entirely clear. In other words, whether the adoption of defense plans led to poor performance remains to be seen. It may be that firms with poor performance tend to expose themselves to hostile bids and so introduced defense plans.

B. INDEPENDENT DIRECTORS

As will be described later, under the current Companies Act in Japan, independent directors are not required for “two-board companies,” which is the most popular board structure among listed firms in Japan. In fact, 97.8 percent of the listed firms on the TSE as of September 10, 2012, were two-board companies, and the remaining 2.2 percent were “one-board and three-committee companies.”¹⁵ Whether independent directors play a positive role in corporate

12. See generally TOKYO STOCK EXCH., INTERIM REPORT OF ADVISORY GROUP ON IMPROVEMENTS TO TSE LISTING SYSTEM (2007), available at www.tse.or.jp/english/rules/ls-improvements/b7gje600000044iq-att/full-text.pdf.

13. See Sumio Hirose et al., *Information Effects of Performance by the Adoption of Takeover Defenses: An Analysis of the Cases*, 1826 SHOJIHOMU 4 (2008) (in Japanese).

14. See *id.*

15. See TSE WHITE PAPER 2013, *supra* note 9, at 15.

governance has been much debated, and several empirical studies on the subject have been conducted. As to whether there are correlations between having outside directors and firm performance, the results of those studies are split.¹⁶

It is interesting to note, however, that empirical studies in recent years try to examine the determinants of board composition. They try to identify factors that may affect the optimal board structure. The hypothesis is that more diversified firms with more branches need directors with different backgrounds and expertise and that firms requiring special knowledge and skills need a greater number of inside directors. Recent empirical studies concerning independent directors in the United States imply that the situation in the United States is consistent with this hypothesis, while empirical studies concerning outside directors in Japan imply the opposite.¹⁷

C. LISTING OF SUBSIDIARIES

While most listed firms on the TSE do not have parent companies, some of them do. Out of 2,275 TSE-listed companies, 356 companies (15.6 percent) have controlling shareholders. Out of these, 67.7 percent (10.6 percent overall) have parent companies, and 32.3 percent (5.1 percent overall) have controlling shareholders other than parent companies. Of the companies with parent companies, 89.6 percent (9.5 percent overall) have listed parent companies. According

16. Compare Yoshiro Miwa & J. Mark Ramseyer, *Outside Directors and Shareholder's Interest*, in HOW TO USE ECONOMICS—INTRODUCTION TO EMPIRICAL APPROACH TO THE JAPANESE ECONOMY 227 (2007) (in Japanese) with Konari Uchida, *The Determinants of the Ratio of Outside Directors and Firm Performance*, 50 SEC. ANALYSTS J. 8 (2012) (in Japanese); Takuji Saito, *The Determinants and the Effects of Having Outside Directors in Japanese Firms*, in CORPORATE GOVERNANCE IN JAPAN—TOWARD REDESIGNING CORPORATE GOVERNANCE AND THE RECOVERY OF COMPETITIVENESS 181 (Hideaki Miyajima ed., 2011) (in Japanese); Hideaki Miyajima & Ryo Ogawa, *How to Understand the Change in the Composition of the Board of Directors in Japan*, 1973 SHOJIHOMU 81 (2012) (in Japanese).

17. See Tomotaka Fujita, *Corporate Governance and the Rule of Soft Law*, 5 U. TOKYO SOFT L. REV. 9 (2013). For the studies in the United States, see, e.g., James S. Linck et al., *The Determinants of Board Structure*, 87 J. FIN. ECON. 308 (2008); Kenneth Lehn et al., *Determinants of the Size and Structure of Corporate Boards: 1935–2000*, 38 FIN. MGMT. 747 (2009); Lucian A. Bebchuk & Michael S. Weisbach, *The State of Corporate Governance Research*, 23 REV. OF FIN. STUD. 939 (2010).

to the TSE, the reason for the large percentage of parent companies being listed is due to the TSE requiring, until January 1, 1996, subsidiaries seeking a new listing to have a TSE-listed parent. According to the TSE, another reason is that the burden on an unlisted parent to list its subsidiary—namely, the TSE Securities Listing Rules requiring a TSE-listed company to perform disclosure regarding its unlisted parent company at a level similar to that for a listed company.¹⁸ Note that as to subsidiaries listed on the TSE that have parent companies (whether they are listed or not), the TSE imposes a set of rules that are not required by the Companies Act.¹⁹

Recent empirical studies tend to indicate that the economic performance of those listed subsidiaries is not consistently worse than other listed firms.²⁰

D. SHAREHOLDER ACTIVISM

Whether shareholder activism plays a positive role in corporate governance is also a topic that has been debated worldwide. There are empirical studies on this topic, and their implications seem somewhat unclear.²¹

III. SCANDALS

Scandals occur everywhere around the globe, and Japan is not an exception. The most well-known scandal in Japan in recent years may be the accounting fraud by Olympus that was discovered in 2011.²² Other well-known scandals in Japan include the private use of firm

18. See TSE WHITE PAPER 2013, *supra* note 9, at 22.

19. See TOKYO STOCK EXCH., LISTING RULES: ARTICLE 441-2 (2009) (*yukashoken jojokitei*, effective June 30, 2010, requiring fairness opinions and disclosure for transactions between a listed subsidiary company and its controlling shareholder).

20. See Hideaki Miyajima et al., *An Economic Analysis of Parent and Subsidiary Listings*, in CORPORATE GOVERNANCE IN JAPAN, *supra* note 16, at 289.

21. See Yasushi Hamao et al., *U.S.-Style Investor Activism in Japan: The First Ten Years*, (Marshall Sch. Bus., Working Paper No. FBE 06-10, 2010). See also John Buchanan, Dominic Heesang Chai & Simon Deakin, *HEDGE FUND ACTIVISM IN JAPAN—THE LIMITS OF SHAREHOLDER PRIMACY* (Cambridge Univ. Press 2012).

22. See FIN. SERVS. AGENCY, THE REPORT OF THE INVESTIGATION COMMITTEE (2012), available at <http://www.fsa.go.jp/policy/kachoukin/05/2012/11.pdf> (in Japanese).

assets by the chairman of Daio-Seishi,²³ and the disappearance outside Japan of pension assets managed by AIJ, a pension fund management company.²⁴ Also, scandals concerning insider trading relating to seasoned stock issuance in 2012 led to the amendments to the FIEA concerning the regulation of insider trading in 2013.²⁵

It may be noted that lawyers tend to view corporate governance as a mechanism to prevent fraud and other scandals, while economists tend to view it as a mechanism to increase firm performance. Thus, the empirical studies noted above examined the correlations between corporate governance and firm performance. There are almost no empirical studies examining the relationship between corporate governance and the prevention of fraud and scandals.

IV. BOARD STRUCTURE

The Companies Act permits a choice between a two-board company and a one-board and three-committee company. In the former, a board of directors and a board of statutory auditors are required, while in the latter (*iinkai-to secchi gaisha*), there are no statutory auditors and the board of directors is required to have three committees—a nominating committee, an audit committee, and a compensation committee (Article 400 through Article 417 of the Companies Act). This latter form was introduced by the amendments to the Commercial Code in 2002 (effective from April 1, 2003). More than half of each committee's members must be “outside” directors. For two-board companies, at least half of the members of the board of statutory auditors must be “outside” statutory auditors, but the board of directors does not have to have outside directors. In practice, one-board and three-committee companies are not popular as far as the number of firms that adopt that form. As noted above,

23. See FIN. SERVS. AGENCY, THE REPORT OF THE INVESTIGATION COMMITTEE (2011), available at <http://www.daio-paper.co.jp/news/2011/pdf/n231020a.pdf> (in Japanese).

24. See SECS. & EXCH. SURVEILLANCE COMM'N, RECOMMENDATION FOR ADMINISTRATIVE ACTION BASED ON FINDINGS OF THE INSPECTION OF AIJ INVESTMENT ADVISORS CO., LTD. (2012), available at <http://www.fsa.go.jp/sesc/english/news/reco/20120705-1.htm>.

25. See FIN. SERVS. AGENCY, EXPLANATORY MATERIALS ON THE AMENDMENTS TO THE FIEA (2013), available at <http://www.fsa.go.jp/common/diet/183/setsumei.pdf> (in Japanese).

only 2.2 percent of the listed firms on the TSE as of September 10, 2012, are one-board and three-committee companies.²⁶

A brief further note on two-board companies may be worthwhile, because statutory auditors are not well-known outside Japan. The Companies Act begins with the familiar position that shareholders are the owners of a joint-stock company. A shareholders' meeting elects directors and makes decisions about "fundamental changes" to the company, such as a merger, a sale of substantially all the firm's assets, and an amendment to the firm's charter. For a two-board company, there must be at least three directors. Directors are elected at the shareholders' meeting, and form the board of directors. The board elects representative directors, the Japanese counterparts of U.S. officers or executives. There must be at least one representative director. Representative directors are the management, and they run the company. The Companies Act requires that the board of directors make the important corporate decisions and supervise the management. Each director, as a member of the board, owes a duty of care and loyalty to the company. The director's liability to the company may be enforced by shareholders through a derivative action. Shareholders have familiar rights, such as the right to make proposals, the right to ask questions to directors and statutory auditors (although the Companies Act calls this the director's or auditor's "duty to explain"), and the right to examine the company's books and records.

A two-board company must have "*kansayaku*," often (somewhat misleadingly) translated as a statutory auditor.²⁷ Statutory auditors are elected at the shareholders' meeting, and do not have to be accountants or other professionals. A "large company," which is defined under the Companies Act as a joint-stock company having either legal capital in the amount of 500 million yen or more, or total

26. TSE WHITE PAPER 2013, *supra* note 9.

27. The Japan Audit and Supervisory Board Members Association ("JASBA") (Nihon Kansayaku Kyokai) recommends that *kansayaku* be translated into English as audit and supervisory board member and *kansayaku-kai* as audit and supervisory board. See JASBA, NEW RECOMMENDED ENGLISH TRANSLATION FOR "KANSAYAKU" AND "KANSAYAKU-KAI" (Oct. 2012), available at <http://www.kansa.or.jp/en/ns121023.pdf>. In this article, I keep the traditional translation and use "statutory auditor" and the "board of statutory auditors."

debt (on balance sheet) in the amount of twenty billion yen or more, must have at least three statutory auditors, and at least half of them must be “outside” statutory auditors. An auditor is “outside” when he or she does not, or did not in the past, serve as a director or employee of the company or its subsidiary (Article 2(16) of the Companies Act). In a large company, there must be at least one full-time auditor.

In addition, a large company must have an accounting auditor (*kaikeikansanin*), who must be a certified public accountant or certified auditing firm. An accounting auditor is elected at the shareholders’ meeting, and is responsible for auditing the company’s financial statements annually before they are submitted to the annual shareholders’ meeting, where the audit opinion is also submitted. In contrast, a statutory auditor is responsible for overseeing the activities of management. This is understood to mean confirming the legality of management’s activities. The Companies Act requires collaboration between accounting auditors and statutory auditors, providing complex rules, the details of which are beyond the scope of this article.

A two-board company may elect an outside director, although this election is not mandatory. If the company has an outside director, the Companies Act permits some special treatment—for instance, decision-making on certain important matters may be delegated from the board of directors to a smaller special board (see Article 373 of the Companies Act). A director is “outside” where he or she is not, or was not, an executive director or employee of the company or its subsidiary (Article 2(15) of the Companies Act).

There are two recent trends in this area. First, as noted below, the TSE today requires listed firms to have at least one “independent” director or auditor and encourages all listed firms to have independent directors. Second, as noted below, the Companies Act is expected to be amended in 2014. Under the Bill for the Amendments to the Companies Act, the definition of “outside” is stricter than under the current law, and having outside directors satisfying the new definition of “outside” is encouraged by introducing a so-called comply or explain rule.

V. STOCK EXCHANGE RULES

The TSE has been active in providing rules concerning corporate governance for listed companies.²⁸ In particular, on August 24, 2009, the TSE introduced a rule concerning new stock issuance to a third party where increased disclosure and explanations are required for the reason why the firm does such issuance.²⁹ Also, on December 30, 2009, the TSE adopted a new rule requiring listed firms to have at least one independent director or statutory auditor, whose name must be notified to the TSE every year.³⁰ The definition of “independent” under the TSE rule is stricter than the definition of “outside” under the Companies Act. In the latter, “outside” means lack of an employment relationship with the company and its subsidiaries in the past, whereas in the former, “independent” means, in addition to being an outsider required under the Companies Act, lack of an employment relationship with the company’s parent firms, lack of a family relationship, and lack of a business or trade relationship.³¹

In practice, the TSE White Paper 2013 reports that the average number of directors per TSE-listed company was 8.13 persons overall. In the 2006 survey, this was 8.99 persons per company, and the trend of decreasing figures since the survey began has continued. This overall trend of decreasing number of directors is also affected by the structure of the board of directors. There are six companies that have more than twenty directors and two of these do not have any outside director. In contrast, there are 472 companies that have no more than five directors. Among them, six companies have more statutory auditors than directors, and the size of the board of directors is equal to the size of the board of statutory auditors in seventy-nine companies; and the number of directors exceeds the number of statutory auditors by only one person in 206 companies. Furthermore,

28. See *generally Improvements to TSE Listing System*, TOKYO STOCK EXCH., <http://www.tse.or.jp/english/rules/lis-improvements/index.html> (last updated Nov. 30, 2010).

29. See TOKYO STOCK EXCH., LISTING RULES: ARTICLE 432 (2009) (effective Aug. 24, 2009).

30. See TOKYO STOCK EXCH., LISTING RULES: ARTICLE 436-2 (2009) (effective Dec. 30, 2009, amended on June 30, 2010).

31. See TOKYO STOCK EXCH., GUIDELINES ON LISTING III-(3)-2 (2009) (effective Dec. 30, 2009).

upon dividing the number of directors by the number of statutory auditors, 1,246 companies have no more than double, including 461 companies with no more than 1.5 times, indicating a decreasing trend despite a certain presence of statutory auditors compared to directors.³²

The TSE White Paper 2013 also reports that the aggregate number of persons notified as independent directors or statutory auditors is 4,815 persons, of which 4,651 persons are accounted for by two-board companies, while 164 persons are accounted for by one-board and three-committee companies. The average number of such persons per listed company is 2.12. This is 2.09 persons at two-board companies and 3.35 persons at one-board and three-committee companies.³³

VI. DISCLOSURE RULES UNDER SECURITIES REGULATION

The disclosure rules under the FIEA were amended in March 2010. The current rules under “*kaiji naikaku furei*” promulgated by the Financial Services Agency (“FSA”) imposes on the reporting companies (which include all listed firms) enhanced disclosure on corporate governance. In particular, reporting companies are now required to provide disclosure of the annual amount of executive compensation for each individual where the annual amount is one-hundred million yen or more.³⁴ They also are now required to provide disclosure of the result of voting at the resolutions of the shareholders’ meeting.

VII. FORTHCOMING REFORM OF CORPORATE LAW

A reform plan of the Companies Act was adopted by the Legislative Council at the Ministry of Justice (“MOJ”) on September

32. See TSE WHITE PAPER 2013, *supra* note 9, at 22.

33. See TSE WHITE PAPER 2013, *supra* note 9, at 52.

34. See *also id.* at 69.

7, 2012.³⁵ The Bill for the Amendments to the Companies Act (“the Bill”) was submitted to the Diet on November 29, 2013.³⁶ It has not yet been passed in the Diet, but is expected to be passed sometime in 2014.

First, the reform of outside directors is expected to be made. The requirement of being outside will become stricter in two respects. In addition to the requirement of lack of an employment relationship with the company or its subsidiaries, lack of an employment relationship with the company’s parent firms will be required (Article 2(15) and Article 2(16) of the Bill).³⁷ Also, lack of a family relationship will be required (Article 2(15) and Article 2(16) of the Bill). Note, however, that lack of a business or trade relationship, required by the current TSE rule for independence, will not be required under the new regime of the Companies Act. Aside from this, having an outside director is encouraged by a comply or explain rule. Specifically, all two-board companies are to be subject to a rule where they must explain the reason why they do not have an outside director, if they do not have one, at the annual shareholder’s meeting (Article 327-2 of the Bill). In addition, under an MOJ rule, such explanation is expected to be required to be made in the annual business report (*jigyo hokoku*) and in the materials in connection with the election proposals of directors at the shareholders’ meeting (*kabunushi-sokai sanko-shorui*).³⁸ In this connection, it is interesting to note that the Legislative Council of the MOJ also made a strong request to stock exchanges that they encourage listed firms to have

35. LEGISLATIVE COUNCIL OF THE MINISTRY OF JUSTICE, MAIN POINTS FOR THE REFORM OF CORPORATE LAW (Sept. 7, 2012), *available at* <http://www.moj.go.jp/content/000102013.pdf> (in Japanese). For an explanation and analysis of the Main Points in English, see also Gen Goto, *The Outline for the Companies Act Reform in Japan and Its Implications*, 35 ZEITSCHRIFT FÜR JAPANISCHES RECHT 13, 14 (2013).

36. The Bill and related materials are available online. *See Bill for the Amendments to the Companies Act*, MINISTRY OF JUSTICE, http://www.moj.go.jp/MINJI/minji07_00138.html (last visited Oct. 20, 2014) (in Japanese).

37. The Bill relaxes the employment requirement in that the definition of outside is satisfied if an employment relationship did not exist for ten years preceding the appointment of the person as an outside director or outside statutory auditor. *See* Article 2(15) and Article 2(16) of the Bill.

38. *See* LEGISLATIVE COUNCIL OF THE MINISTRY OF JUSTICE, *supra* note 35.

outside directors.³⁹

Second, a new type of company is expected to be introduced as “*kansa-to iinkai secchi gaisha*,” a company with a one-board and one-committee structure (where there are no statutory auditors and the majority of the committee members must be outside directors) (Article 399-2 through Article 399-14. of the Bill). As a result, listed firms will have the choice of three board structures: (i) two boards, (ii) one board and three committees, and (iii) one board and one committee. This one-board and one-committee structure is intended to encourage listed firms with a two-board structure to move to that structure and thereby have outside directors.⁴⁰

Third, for public companies, a large-scale stock issuance that would create controlling shareholding (that is, majority holding of voting stocks) will, in principle, require approval at the shareholders’ meeting (Article 206-2 of the Bill). The technical operation of this new rule is complicated and not discussed here.

Finally, in parent-subsidiary situations, a so-called multi-layer shareholder derivative action will be introduced, although it is to be recognized under limited circumstances. Under the new regime, where a director of a subsidiary owes liability to the subsidiary, a shareholder of its one-hundred percent parent company (if he or she has one percent or more of the voting stocks for six months or otherwise satisfies specified conditions) will be given the right to sue the director of the subsidiary in the form of a derivative action (if the subsidiary is large enough to account for more than twenty percent on the parent’s balance sheet or otherwise satisfies specified conditions) (Article 847-3 of the Bill).

VIII. CONCLUSION

In 2008, I explored the question of what shapes corporate law in

39. *Id.* On the date when the bill was submitted to the Diet, the TSE made an announcement in that direction. See TOKYO STOCK EXCH., REVISIONS TO LISTING RULES CONCERNING SECURING HIGHLY INDEPENDENT OUTSIDE DIRECTORS (2013), available at <http://www.tse.or.jp/english/about/rules/comment/b7gje6000001sb2p-att/b7gje6000001sbcb.pdf>.

40. See Hideki Kanda, *Reform of the Companies Act*, 169 Ho no Shihai 8 (2013) (in Japanese).

Japan.⁴¹ In the United States, whether Delaware corporate law is the result of the “race to the bottom” or the “race to the top” has been much debated. In 2005, Professor Mark Roe reminded us of the importance of the race between state corporate law and federal law.⁴² These debates have one thing in common: corporate law in the U.S. has been shaped and developed through competition among legislators. What about Japan? Japan does not adopt a federal system, and thus, there is only one set of corporate law in Japan. This simply suggests that competition between states or between state and federal legislators does not exist in Japan. Does this mean that there are no competitors in Japanese corporate law? Certainly, there are competitors outside Japan, and indeed, Japanese corporate law has been influenced by the corporate laws of other jurisdictions. More generally, the familiar debate on convergence or divergence of corporate laws around the world suggests that there is competition among corporate laws worldwide. Yet, what about competition within Japan?

It is submitted that there is competition in shaping corporate law within Japan, and that this competition is among enforcers.⁴³ More specifically, regulation, in particular, a set of rules commonly called securities law or regulation, serves as a competitor to what is commonly called corporate law in Japan. Today, stock exchange rules and their enforcement serve as an additional competitor to corporate law in Japan. How legal rules on corporate governance are shaped in Japan and other jurisdictions would seem to remain an interesting topic for a future research agenda.

41. Hideki Kanda, *What Shapes Corporate Law in Japan?*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 60 (Hideki Kanda et al., eds., 2008).

42. See Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 591 (2003); Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491 (2005).

43. Kanda, *supra* note 41.